

SUSTAINABILITY IN ACCOUNTING – BASIS: A CONCEPTUAL FRAMEWORK

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ABSTRACT: This paper motivation is to introduce a few guidelines of a model in search for a conceptual framework for sustainability reporting. We are presenting the levels of information reliability which are derived mainly from accounting conceptual frameworks, and Global Reporting Initiative (GRI) Guidelines. As the study methodology we are using an inductive approach: we analyze the qualitative characteristics of specific environmental indicators, in order to assess the degree of relevance and reliability of each particular provision. We will finally make an attempt to derive the objective of sustainability reporting, while evaluating the degree of usefulness of this type of documents that closely follow the more formalized process of financial reporting. We conclude that there are a number of reasons for not reporting; most of these are related to internal data reliability. Hence, stakeholders cannot distinguish between different types of data unreliability; and the GRI does little on this matter.

Key words: Sustainability, Global Reporting Initiative (GRI) Guidelines, conceptual framework, inductive approach

JEL codes: M40, G30, H11

1. INTRODUCTION

The quality of information available to managers is associated with cross-sectional differences in firm characteristics (Yhim H.; Karim E., Rutledge R., 2003). This is the trend the level of information quality is going, moreover information comes with a cost, paid by the reporting entities; at the same time, a good quality information is presumed to generate benefits for the internal users and for the external ones. This being said, costs and benefits can be identified and quantified; the corporate actors may experience the costs of transparency, while enjoying at the same time the benefits of being informed on market evolutions at the most suitable time.

We try to deal in our research with a number of concepts not properly identified so far, (Greuning, 2006: 7). *Transparency* is the truthful correlation between discourse and its underlying reality. *Disclosure* refers to the process and methodology of providing the information and making policy decisions known through openness and timely dissemination. The conceptual separation between transparency and disclosure comes from the factual details of transforming the objective of the ‘true and fair view’ into reality through a continuous and high-quality flow of information.

Accountability refers to the need for market participants, including the authorities, to justify their actions and policies and accept responsibility for their decisions and results. The pro-principles rhetoric that surrounds the notion of transparency reflects a desire to promote ethical values, emphasizing the descriptive as well as the normative qualifications of these concepts (Cunningham, 2007).

We identify in our research a tryout in delineating a correct view in what the sustainability reporting is regarded. The implementation of widely accepted framework, such as the Global Reporting Initiative (GRI) Guidelines is very difficult. The problems of sustainability reporting relies in the basis of this GRI. Firstly we identify the institutional foundations and the mission of

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GRI, furthermore verify for the qualitative characteristics of reporting – reliability and relevance – in the conception of the GRI performance indicators. Two levels of reliability are described, mainly derived from accounting conceptual frameworks (e.g. FASB), the sources of inspiration for the reporting principles of GRI. Finally, the assessment of relevance and reliability calls for the identification of major flaws in the presentation of the ‘true and fair view’ from the GRI perspective.

2. SUSTAINABILITY – SUSTAINABLE REPORTING

To arrive at a more operational concept of sustainability necessary for recommendations regarding daily life the detailed consequences of this first and very general definitions have to be understood. There is no single, all-over accepted definition of sustainable reporting. It is a broad term mainly used to describe a company’s reporting on economic, environmental and social performance. It can be synonymous with triple bottom line reporting, corporate responsibility reporting. Sustainability reporting is becoming more prevalent, driven by>

- a growing recognition that sustainability related issues can materially affect a company’s performance,
- demands from various stakeholders groups for increased levels of transparency and disclosure and
- the need for companies (and the business community more generally) to appropriately respond to issues of sustainable development;

An important distinction is made between sustainability reporting and corporate philanthropy, that latter being defined as the act of donating money, goods, time or effort to support a charitable cause.

Some of the most known *definitions of sustainability reporting* are the following:

- Sustainability reporting is... the practice of **measuring, disclosing, and being accountable** to internal and external stakeholders for organizational performance towards the goal of sustainable development. (GRI)
- Corporate sustainability is business approach that creates long term shareholders value by embracing opportunities and managing risks deriving from economic, environmental and social development.

Corporate sustainability leaders achieve long term shareholders value by gearing their strategies and management to harness the market’s potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks. (Sow Jones Sustainability Index)

The release of the Brundtland Report in 1987 and the subsequent Summits of Rio and Johannesburg supported by the United Nations have helped to bring about the development of a shared consciousness on the need to reflect on how society can contribute to social welfare without threatening survival of bio-diversity. Nowadays, the most widely accepted definition of *sustainable development* is that proposed in the Brundtland Report: “Development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (World Commission on Environment and Development, 1987).

The trend towards sustainability reporting has been driven by two principal factors. First, increase recognition of the potential for sustainability related issues to materially affect a company’s long term economic performance. Secondly, the need for the business community (and individual companies) to appropriately respond to issues of sustainable development.

Sustainable development is commonly defined as “meeting the need of the present generation without compromising the ability of future generations to meet their own needs”

2.1. The foundations of GRI

Environmental reporting, the precursor of sustainability reporting, took shape in the early 1990s as part of the search for tools to enhance accountability. The 1989 Principles of the Coalition for Environmentally Responsible Economics (CERES) – shared corporate social responsibility (CSR) and multi-stakeholder alliances – were readily taken up by those environmental advocates who stressed the necessity of business participation in solving global environmental problems (Enderle, 2004). The 1992 UN Conference on Environment and Development in Rio was a turning point in the balance of power between global corporations, governments, and the society. Acting from the platforms of the International Chamber of Commerce and the newly created Business Council for Sustainable Development (since 1995 World Business Council for Sustainable Development, WBCSD), the corporate sector presented itself as not only part of the environmental problem, but also an essential part of the solution.

The year 1997, environmental reporting took a turn when launching the GRI by CERES in partnership with the United Nations Environmental Program. Its goal was to enhance the quality, rigor, and utility of sustainability reporting. It was an attempt to integrate and unify the many standards in the marketplace into a single, generally accepted sustainability reporting framework, encompassing environmental, social and economic performance.

The first official edition of the GRI Guidelines was released in June 2000, and the work on the next edition commenced immediately thereafter. By August 2002, the second edition of the Guidelines was released in Johannesburg during the World Summit on Sustainable Development, which was followed in quick succession by a series of supplements tailored for individual industrial sectors and by scores of technical protocols and resource materials. By the end of 2005 the governance structure of GRI was completed. The third generation of the Guidelines (G3) – addressed within this paper – was released in October 2006.

The guidelines are for voluntary use by organisations reporting on the triple-bottom-line (economic, environmental, social) dimensions of their activities, products and services. According to GRI, a number of key trends has fuelled its swift progress: expanding globalisation; the search for new forms of governance; reform of the corporate governance in the light of stakeholder theory; global role of emerging economies; rising visibility and expectations for multinationals; measurement of progress toward sustainable development; governments' and financial markets' interest in sustainability reporting; and the emergence of next-generation accounting (Graham & Woods, 2006).

The constructive levels of this idea can be found in a wide range of new literature regarding this issue (Hess, 2005, Ballou *et al.*, 2006;) on sustainability reporting are as follows: triple-bottom-line reporting, also known as sustainability reporting, involves reporting nonfinancial and financial information to a broader set of stakeholders than just the shareholders. Through the consistent and inevitable exposure that results from this high level of transparency, companies are motivated to improve their performance on a range of indicators to demonstrate continued improvement and outperform others in their sector.

The constructive role of reporting is a by-product of the development of a pluralistic system of accountability in stakeholder networks (Benner *et al.*, 2004). Among the different accountability mechanisms, reputational accountability is of prime importance for guaranteeing accountability in networks. Since not only information but also sanctions have to be part of our understanding of accountability, the loss of credibility is one of the most effective negative sanctioning mechanisms for companies, governments, individuals and civil society organisations. The company's stakeholder-oriented activities – as implementations of ideas derived from stakeholder theory – seem to find their legitimacy in the company's capacity of delivering quantitative and qualitative statements (Zambon & Del Bello, 2005).

2.2. Principles and rules for a tentative conceptual framework

The GRI framework is a self-declared principle-centric reporting framework.. The principles are organized into two groups: 1) principles for determining the topics and indicators on which the organization should report; and 2) principles for ensuring the quality and appropriate presentation of reported information (GRI, 2006). The structure of accounting theory (e.g. the FASB Conceptual Framework, as in Financial Accounting Concepts No.1 – *The Objectives of Financial Reporting by Business Enterprises*), the inspirational source of the GRI framework.

The principles-centric claim of the GRI framework needs a careful analysis. In the relevant literature found principles and rules can be classified according to:

a) Their temporal orientation: rules define boundaries and provide guidance, while principles define them after. In the case of reporting principles, a certain point of disclosure on sustainability can be considered to lack materiality, or reliability, or completeness, only when it is integrated into the final report and released to the public, thus *ex post*. Such kind of evaluation can sometimes imply a high degree of subjectivity. For example, a company may choose to disclose total water discharged by quality and destination (EN21); a “rule” may sound like this: “companies should have a specific technique to measure water discharges, otherwise their disclosures are unreliable”. The respective GRI principle states that “If the reporting organization does not have a meter to measure water discharges, this figure needs to be estimated by subtracting the approximate volume consumed on-site from the volume withdrawn”. In this case, it is up to the public to decide whether the approximation is a relevant figure, or just an arithmetic exercise.

b) Their relative generality versus specificity, abstractness versus concreteness, universality versus particularity. Provisions characterized by generality, abstractness, or universality are principles, while those that are specific, concrete, and particular are rules.

c) Their discretion reposed in designated actors: the more discretion a provision reposes, the more it is principle-like, and the less-discretion reposes, the more it is rule-like. This approach mimics the first point of our taxonomy, in assuming that groups of actors can exhibit high levels of discretion based on the likeliness of a system to be principles-oriented rather than the opposite. Voicu D., (2009)

Cunningham (2007) considers that principles may promote conservatism among regulated actors, protect other participants, and have longer shelf lives. In the case of sustainability reporting, if we rule out market efficiency as an objective of the system, and if we consider that fairness can only be achieved through extensive disclosure and stakeholder scrutiny, we may argue that a principles-based system, embedding the above traits, may be the best solution to the problem of sustainable development. In general, prioritizing fairness and contextual analysis leads to the formulation of principles; nevertheless, the desirability of a rule over a principle depends on the clarity with which one can define the importance of relative objectives.

In the following as using an step by step approach: we analyze the qualitative characteristics of various indicators of the GRI, in order to assess the degree of relevance and reliability of each particular regulatory instance. We will then proceed to suggesting an objective of sustainability reporting, while evaluating the degree of usefulness of this type of document that emanate from self-regulatory initiatives.

3. A MODEL OF SUSTAINABILITY

3.1. Transparency

Transparency can be envisaged as a multi-level concept that is useful for evaluating the quality of all types of reports, moreover economic report, and financial statements. The multi-layer framework described in the dedicated literature imagines transparency as a hierarchy of lenses that should ultimately provide a view of the firm’s economic performance and financial position. A lack of transparency at a high level automatically reduces transparency at lower levels (Mensah *et al.*, 2006):

□ Transparency level 1 (Transactions and Events) is the most critical transparency level because any significant occlusion at this level would lead to a distorted view of the firm's economics irrespective of transparency at other levels.

□ Transparency level 2 (Accounting Methods) allows the user to judge whether measurement methods are acceptable and comparable to those of other entities.

Along the short history on sustainable reporting, the issue of sustainability measurement techniques has been treated several times, and by more than one author (Lamberton, 2005). It can be said that the use of indicators to estimate variables that cannot be measured precisely has a long history in environmental science, where variables that are inherently complex cannot be directly observed (Lamberton, 2005).

Total energy saved by efforts to reduce energy use and increase energy efficiency (EN5). Reduced energy consumption from reduced production capacity or outsourcing should not be included in this Indicator. We claim that an estimate of energy saved can only be provided *ceteris paribus*, when all other factors are held fixed over a period of time – say, one year. By “all factors”, we refer to keeping all levels of activity steady, which is not a realistic assumption.

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Indirect energy use through purchasing materials and components or services such as travel, commuting, and subcontracted production (EN7). When monitored comprehensively, indirect energy use can be reduced effectively (e.g., by carefully selecting energy-efficient materials, services, or production capacities, or substituting phone or video conferences for travel). In contrast, we affirm that relevant upstream/downstream indirect energy use is not directly measurable except for the costs borne by the employees or the company in their name. Whenever one type of service is found a replacement, a reliable evaluation for the latter should also be provided.

Significant direct and indirect positive and negative impacts (EN12) with reference to the following: species affected; extent of areas impacted (this may not be limited to areas that are formally protected and should include consideration of impacts on buffer zones as well as formally designated areas of special importance or sensitivity); duration of impacts; and reversibility or irreversibility of the impacts. The first remark concerning this indicator focuses on the costs of establishing the significance of environmental impacts. The lower the amounts invested in assessing such aspects, the less the reported significance; a company seeking to maximize shareholder value is highly unlikely to decrease profits in order to investigate past damages inflicted to the environment. Secondly, significant impacts occur over extensive periods of time; the point in time when an impact becomes significant is at the managers' discretion.

One other element in measuring the sustainability of reporting through reliability is the materiality principle. In the context of the GRI Guidelines, materiality is defined as:

...the threshold at which an issue becomes sufficiently important that it should be reported. [...] A combination of internal and external factors should be used to determine whether information is material, including factors such as the organization's overall mission and competitive strategy, concerns expressed directly by stakeholders, broader social expectations, and the organization's influence on upstream (e.g., supply chain) and downstream (e.g., customers) entities (GRI, 2006).

The principle of materiality holds that transactions and events having insignificant economic or sustainability effects may be handled in the most expeditious manner, and need not be disclosed. Materiality serves as an implicit guide for the reporting entity in terms of what should be disclosed in company reports, enabling the organization to decide what is not important or what does not matter on the basis of record-keeping costs, accuracy of statements, and relevance to the users. However, the materiality principle lacks an operational definition. Most definitions of materiality stress the reporting entity's role in interpreting what is and what is not material (Riahi-Belkaoui, 2004).

A controversial environmental performance indicator is concerned with the monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations (EN28). The organization should report on significant fines and non-monetary sanctions in terms of: a) total monetary value of significant fines; b) number of non-monetary sanctions; and c) cases brought through dispute resolution mechanisms. However, the literature has showed that the high esteem held for materiality may become a cover-up of a lack of full disclosure regarding the ethical, social and environmental impacts of particular companies. A recent case study analyses company Alpha's sustainability reporting practices; the following excerpt supports our contentions:

The two pages in the 1999 annual review give a similarly unproblematic impression of progress though it mentions a £2,000 fine for "two losses on containment in 1998". Alpha was top of the Environment Agency's list of fines for pollution by companies in England and Wales published in March 1999 with fines amounting to £382,500 for pollution during 1998 (Adams, 2004).

So the materiality principle – information is deemed material only if its omission or misrepresentation could influence the decisions and actions of stakeholders – would be effective and trust-inspiring only in the presence of external assurance. Assurance statements need to move beyond this restrictive approach which implicitly defines materiality as it pertains to management (O'Dwyer & Owen, 2005).

3.2. Independent assurance

In what the independent and so being –external assurance is regarded, is definitely more trust worthy than an internal one. Assurance is an evaluation, against a specific set of principles and standards, of the extent of the accountability to stakeholders provided by specified public reports. It involves an examination of the quality of the systems, processes and competencies that deliver the information underpinning the reporting organisation's performance (AccountAbility, 2003). The Guidelines specifies that the use of external assurance is *recommended, but not mandatory*, for sustainability reports, while a variety of approaches are suggested: the use of professional assurance providers, stakeholder panels, and other external groups or individuals. The GRI uses the term 'external assurance' to refer to activities designed to result in published conclusions in the quality of the report and the information contained within it. This is different from activities designed to assess or validate the quality or level of performance of an organisation, such as issuing performance certification or eco-labeling.

Overall, the key qualities for external assurance of reports using the GRI Reporting Framework are that it:

- Recommends the provision of independent assurance conducted by groups or individuals external to the organization who are demonstrably competent in both the subject matter and assurance practices;
- Utilizes groups or individuals to conduct the assurance who are not unduly limited by their relationship with the organization or its stakeholders to reach and publish an independent and impartial conclusion on the report; Assesses the extent to which the

report preparer has applied the GRI Reporting Framework (including the Reporting Principles) in the course of reaching its conclusions; and

- □ Results in an opinion or set of conclusions that is publicly available in written form, and a statement from the assurance provider on their relationship to the report preparer (Ballou et al., 2006).

More and more companies use IASE 3000-International Standards on Assurance Engagements as an auditing standards, this is one of the reasons why trying to achieve a good standard will be doable. Formal standards remove discretion from the auditor and reinforce its claim to be acting independently of the firm being audited. Further, auditing standards make it easier for all stakeholders to determine whether the assurance process itself was completed successfully (Graham & Woods, 2006). The European Commission argues that:

Verification by independent third parties of the information published in social responsibility reports is also needed to avoid criticism that the reports are public relations schemes without substance. Indeed such services are already beginning to be offered by a variety of companies, which would seek to perform them following agreed standards. The involvement of stakeholders, including trade-unions and NGOs, could improve the quality of verification (Commission of the European Communities, 2001: 18).

As it follows we present one of the notorious criticisms of current assurance practices of social, ethical and sustainability reports concerns the huge audit expectations gap (Adams & Evans, 2004), resulting from several factors particularly apparent when comparing the work of financial and sustainability assurers.

Different from the financial audit report, there are no guidelines specifying what type of sustainability assurance opinion should be issued on what circumstances, presenting difficulties in conveying the appropriate guarantees. In the absence of generally accepted assurance standards, high-level assurance cannot be offered (O'Dwyer & Owen, 2005: 223).

When financial audit is mandatory, sustainability assurance is not a legal requirement. This characteristic is a corollary of the adherence to the self-regulatory regime. Even if the organization opts for voluntary compliance to the GRI Guidelines, it cannot be forced to submit its reports for external assurance.

Agreeing to relevant accounting principles must be obviously marked up in the financial statements, while the sustainability certifying person has but the GRI Principles and qualitative characteristics to report upon. Nowadays there are a current that precise that this principles: We materiality, sustainability context, and completeness – and qualitative characteristics: balance, timeliness, accuracy, clarity, comparability and reliability – are vaguely defined and provide considerable incentives for managerial discretion. (Voicu D., 2009)

Audit's purpose and instruments are mandatory only for the person whom certifies a situation which may alter credibility in the collection and interpretation of evidence.

A recent set of analyses (Kolk, 2004) of verification statements included in sustainability reports have shown that the audit assignment had varied widely in content and scope, ranging from assurance on data consolidation, data generation at the local level, completeness of the issues covered, internal compliance with policies, consistency with the data in the financial report, to the adequacy of companies' information on environmental management systems. Of the audit statements 40% contained subjective wordings, which were not fully based on the work performed. Thus, the very fact that a report has been audited does not imply that its data and all its contents have been checked thoroughly and are fully reliable.

4. A FEW GUIDELINES FOR THE OBJECTIVE OF SUSTAINABILITY REPORTING

Sustainable development ties together concern for the carrying capacity of natural systems with the social challenges facing humanity. As early as the 1970s "sustainability" was employed to describe an economy "in equilibrium with basic ecological support systems.

Many sustainability criteria are derivable from the same core ethic of intergenerational equity. Choosing a sustainability criterion that is appropriate to a given policy context requires judgement on which natural and man-made resources are significant inputs to production and welfare, and on how essential and substitutable they are. The notion that conventional environmental policies may improve sustainability is important. Suggestions for further research work are made.

Increasing recognition that the overall goals of environmental conservation and economic development are not conflicting but can be mutually reinforcing, has prompted calls for 'environmentally sustainable' economic development. Although there are difficulties in defining sustainable development in an analytically rigorous way, there is still a need to evolve a concept of sustainability that both distinguishes it from other post-war meanings of development and is useful for practical analysis and policymaking. (Barbier B., 2009)

This concept is widely recognized as a multi-tier concept; the tiers are highly interdependent, and global sustainability can only be achieved through action at every level (Lamberton, 2005). Sustainability reporting is an attempt to provide additional accounts which will capture some of the externalities and, by doing so, to encourage behavior which will ameliorate the consequences of unsupervised economic activity (Moneva et al., 2006). The GRI framework imposes that the report should present the organization's performance in the wider context of sustainability (GRI, 2006: 11. Rather than merely relying on generally accepted accounting principles as the only measurement method, Bedford called for the development of new tools to provide management and decisions-makers with useful information:

- a) An expansion of the scope of users from shareholders, creditors, managers and the general public, to groups of stakeholders;
- b) An expansion of the scope of users from evaluating economic progress, to providing for intercompany coordination, meeting specific user information needs and developing public confidence in firm activities;
- c) An expansion of the type of information from transaction-based monetary valuations, to data aiming to reveal both internal activities and the environmental setting of the internal activities;
- d) An expansion of measurement techniques from arithmetic and the bookkeeping system to the total management science area;
- e) An expansion of the quality of disclosure from excellent in terms of past needs to improved relevance for specific decisions;
- f) An expansion of disclosure devices from conventional financial statements to multimedia disclosures based on the psychology of human communications.

Just as truth and fairness are inextricably linked to reliability, sustainability accounting information must exhibit the qualitative attributes of transparency and comparability in a relevant sustainability context to enable stakeholders to assess the environmental and social impact of the organization (Lamberton, 2005). The hypothesis behind the implementation of the GRI Guidelines is that the developed indicators, incorporated in reports respecting the Principles, should offer a strong prospect of escaping the problems of anecdote and incomparability that have affected the reporting of environmental and social impacts. Though much relevant information remains unquantifiable, standardized reporting facilitates systematic inter-firm and inter-temporal comparisons (Graham & Woods, 2006).

5. CONCLUSIONS

The common goal of the two intertwined conceptual realities is imposing a discipline that goes beyond legal compliance (Buhmann, 2006; Greuning, 2006). Transparency and accountability are mutually reinforcing. Transparency enhances accountability by facilitating monitoring, and accountability enhances transparency by providing an incentive for agents to ensure that the reason for their actions are properly disseminated and understood (Dragomir, 2008). The process of disclosing specific aspects of unsustainability, with a detailed exposure of its causes and consideration of alternative paths could prove a significant and cathartic experience (Lamberton, 2005: 7). Empirical evidence supporting these assertions has proved the existence of a positive association between environmental performance and the level of discretionary disclosures in environmental and social reports. In other words, superior environmental performers are more forthcoming in truly discretionary disclosure channels, as predicted by economics based voluntary disclosure theories (Clarkson *et al.*, 2007).

There are a number of reasons for not reporting; amongst them, the doubts about the advantages it might bring, the already good reputation of the company, the cost-benefit considerations, or the difficulty to gather consistent data are some of the most prominent (Kolk, 2004). However, when the organization does choose to report on sustainability, the worst scenario usually involves strategic disclosure. Many authors (Hess, 2005; O'Dwyer & Owen, 2005) have expressed concern that reporting processes have become prone to 'managerial capture' in that corporate management has taken control of the entire process of reporting, thus resulting in information disseminated only when deemed appropriate to collect reputational benefits, rather than seeking true transparency and accountability to stakeholders.

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